

## Internal Revenue Service

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PLR-142169-07

Date:

December 20, 2007

### LEGEND:

State =

State System =

Agency =

Trust =

Act =

Program =

Statute I =

Statute II =

Statute III =

Date I =

Date II =

Dear \_\_\_\_\_ :

This is in response to a letter dated August 1, 2007, and subsequent correspondence submitted by Trust, requesting a ruling that the income of Trust is excludable from gross income under section 115(1) of the Internal Revenue Code ("Code").

## FACTS

State System is sponsored by State and serves to administer death, disability and retirement benefits on behalf of various active and former State employees. Under Statute I, State System is overseen by a Board of Trustees comprised of fourteen elected, appointed, or ex-officio members. The Board of Trustees' duties include directing management of an investment portfolio, adopting actuarial assumptions needed to fund State System, approving disability retirements, and adopting rules, regulations, policies, and procedures necessary to administer the various plans. State Agency assists the Board of Trustees by collecting contributions, supervising management of the investment portfolio, counseling members, and administering the death, disability, and retirement benefits for the twelve separate retirement plans provided by law.

Trust was established by State legislature, through passage of Act, to assist State in providing health and welfare benefits to eligible retirees, their spouses, and dependents (as defined in section 152 of the Code, determined without regard to subsections (b)(1), (b)(2) and (d)(1)(B)). According to Act, Trust Agreement became effective Date I, and Board of Trustees serves as Trustees of Trust. The Trustees adopted the Trust Agreement on Date II, thereby accepting their role as Trustees for Trust.

Program was established by Statute II to provide various health insurance and other benefits for State employees, retirees and their dependents. Pension and retirement benefits are specifically excluded from the Program by Statute III. Trust may be used as a funding vehicle for Program, whereby the Agency as Trust administrator, will accept and account for and forward contributions to Trust for holding and administration. Trustees will invest the funds and transfer assets of Trust to the Department of Budget and Management solely to provide health and welfare benefits to retirees, spouses, and dependents of retirees. If for any reason the State discontinues Program, the assets of Trust will be transferred to the State general fund.

## LAW AND ANALYSIS

Section 115(1) of the Code provides that gross income does not include income derived from the exercise of an essential governmental function and accruing to a state

or a political subdivision of a state.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from a fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its political subdivisions, is excludable from gross income under section 115. The ruling explains that the investment of positive cash balances by a state or political subdivision thereof in order to receive yield on the funds until needed to meet expenses is a necessary incident of the power of the state or political subdivision to collect taxes or other revenue for use in meeting governmental expenses. In addition, the ruling also provides that because the state and its participating political subdivisions have an unrestricted right to their proportionate share of the investment fund's income, the fund's income accrues to them within the meaning of section 115(1). Rev. Rul. 77-261 points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out those projects desirable from the standpoint of the state government which, on a broad consideration of the question, may be the function of the sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that income of an organization formed, operated and funded by political subdivisions of a state to pool their casualty risks is excluded from gross income under section 115(1). The ruling also holds that income of such an organization formed to pool risks in lieu of purchasing insurance to cover their public liability, workers' compensation, or employees' health obligations is excluded under section 115(1) if private interests do not, except for incidental benefits to employees of the participating state and political subdivisions, participate in or benefit from the organizations.

Trust provides health benefits to eligible retired State employees and their dependents. Providing health benefits to current and former employees constitutes the performance of an essential governmental function. Based upon Rev. Rul. 77-261 and Rev. Rul. 90-74, Trust performs an essential governmental function within the meaning of §115(1) of the Code.

The income of Trust accrues to the benefit of State. State is the sole participating employer in Program. No private interests participate in or benefit from the operation of Trust. The benefit to participating employees is incidental to the public benefit. Upon dissolution, assets of Trust will revert to State.

## RULINGS

Based on the information and representations submitted, we hold that the income of Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for the purposes of §115(1). Accordingly, Trust's income is excludable from gross income under §115(1) of the Code.

Section 6012(a)(2) and Treas. Reg. § 1.6012-2(a)(1) provide, in general, that every corporation, as defined in § 7701(a)(3), subject to taxation under subtitle A is required to file an income tax return regardless of whether it has taxable income or regardless of its gross income. See Rev. Rul. 77-261.

Section 6012(a)(4) provides that every trust having for the taxable year any taxable income or having gross income of \$600 dollars or more, regardless of the amount of taxable income, must file an annual income tax return.

If Trust is classified as a trust for federal income tax purposes, no annual income tax return is required to be filed by Trust pursuant to § 6012(a)(4) since any income realized by Trust is excluded from gross income under § 115(1) of the Code. However, if Trust is a corporation, as defined in § 7701(a)(3), it will be required to file an income tax return pursuant to § 6012(a)(2).

No opinion is expressed concerning the federal tax consequences of Trust under any other provision of the Code other than those cited above. In particular, no representation is made regarding the federal tax consequences of contributions to or payments from Program, including (but not limited to) whether contributions to Program are excludable from gross income of retirees under § 106 and whether payments from Plan (including reimbursements for medical expenses) are excludable from the gross income of retirees under sections under §§ 104 or 105.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

In accordance with a Power of Attorney on file, we are sending a copy of this letter to your representatives.

Sincerely,

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SYLVIA F. HUNT  
Assistant Chief  
Exempt Organizations Branch 2  
Division Counsel/Associate Chief Counsel  
(Tax Exempt and Government Entities)

Enclosures:

Copy of this letter

Copy for § 6110 purposes